

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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Telephone Number:

Refer Reply To:
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Date:
June 17, 2002

LEGEND

Company =
Affiliated Company =
Letter X =
Date 1 =
Date 2 =

Dear

This letter responds to the March 22, 2002 request for a ruling on behalf of the Company regarding the proper treatment under § 1374 of the Internal Revenue Code of 1986, as amended ("Code") of income recognized from agreements allowing the limited use of X (the "X"). Additional information was received in a letter dated May 15, 2002.

Company, a C corporation organized on Date 1, owns X which it copyrighted and has the rights to other X which also have been copyrighted by an Affiliated Company (the "Copyrights").

Company grants customers, for a fee and subject to an agreement (the "Agreement") setting forth the terms and conditions of the grant, a one time use of the X(s). Company has indicated that except for the limited use allowed by the Agreement, it retains all rights to the Copyrights and vigorously pursues any use of the X(s) which violates the Agreement.

Company computes its federal income tax liability using the cash method of accounting and files its federal income tax returns on the calendar basis. Company proposes to make an election to be taxed as an S corporation within the meaning of § 1361 of the Code effective for tax years beginning on Date 2 (the "Conversion Date").

Company requested a ruling that the income it receives during the recognition period from Agreements entered into after the Conversion Date will not constitute

recognized built-in gain within the meaning of § 1374(d)(3) of the Code.

Section 1374(a) of the Code imposes a corporate level tax on a S corporation's net recognized built-in gain during the recognition period (generally 10 years) following (a) a C corporation's conversion to S corporation status, or (b) an S corporation's acquisition of assets in a transaction in which the S corporation's basis in the acquired assets is determined by reference to the basis of such assets in the hands of a C corporation.

Section 1374(d)(2) of the Code provides that an S corporation's net recognized built-in gain for any tax year is generally computed as if it was a C corporation, but taking into account only those items treated as recognized built-in gain or recognized built-in loss.

Section 1374(d)(3) of the Code provides that recognized built-in gain includes any gain recognized on the disposition of an asset during the recognition period, except to the extent the S corporation shows that (a) it did not hold the asset on the Conversion Date, or (b) the gain recognized was greater than the excess of the asset's fair market value over its adjusted basis on the Conversion Date.

Section 1.1374-4(a) of the Income Tax Regulations provides that § 1374(d)(3) of the Code applies to any gain or loss recognized during the recognition period in a transaction that is treated as a sale or exchange for federal tax purposes.

Based solely on the information submitted and the authority set forth above, we rule that the income received by the Company from any Agreement entered into with customers of Company after the Conversion Date will not constitute recognized built-in gain within the meaning of § 1374(d)(3) of the Code.

No opinion is expressed about the tax treatment of the income from the Agreements under other provisions of the Code and regulations or the tax treatment of any conditions existing at the time of, or the effects resulting from, the income of the Agreements that are not specifically covered by the above ruling. In particular, no opinion is expressed about the tax treatment that may be realized by Company during the recognition period under § 1374 of the Code other than from the income received from Agreements entered into after the Conversion Date.

This ruling is directed only to the taxpayer requesting it. Section 6100(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to Company's federal income tax returns for Company's final year as a C corporation and for each recognition period year in which the Company receives income from Agreements entered into after the Conversion Date. Pursuant to the Power of Attorney on file with this office, a copy of

this letter is being mailed to your authorized representatives.

Sincerely yours,

Alfred C. Bishop, Jr.

Alfred C. Bishop, Jr.
Branch Chief, Branch 6
Associate Chief Counsel (Corporate)

Enclosure

Baltimore, MD 21202